

## **Assessing payment adequacy in the traditional Medicare program**

**ISSUE:** The adequacy of the current level of payments and the update needed for the coming year have frequently been considered together, causing confusion if not tension. Should we develop a separate process for assessing the adequacy of base rates to precede determination of an appropriate update? What factors should be taken into account in assessing payment adequacy? What measures of financial performance are most useful?

**KEY POINTS:** An overall assessment of payment adequacy would allow policymakers to bypass the imprecise process of determining which factors have contributed to payments being too high or too low and in what proportions. The process would normally entail four steps:

- Determine the appropriate breadth of service coverage. We believe the most practical approach will usually be to assess payment adequacy for all services provided by a type of provider (such as hospitals or dialysis facilities).
- Measure current performance, which we can view as determining how much money is currently in the system. This step should take into account the impact of any recently enacted policy changes.
- Determine an appropriate level of performance, which we can view as deciding how much money should be in the system. This assessment can take numerous factors into account, ranging from an appropriate target margin to the amount of entry or exit of providers.
- Implement an adjustment to the base rate, which we can view as getting to where we want to be.

This would typically take the form of an increment added to or subtracted from the update otherwise thought appropriate, with phasing in as necessary.

In addition to these steps, we address three major issues in this paper that may arise in the process of assessing payment adequacy:

- the appropriate indicators to measure financial performance,
- the relationship between level and distribution of payments, and
- the relationship between Medicare payments and other provider revenues.

**ACTION:** Commissioners should discuss the issues raised in this paper. Your deliberations will help shape the chapter on payment adequacy in the March Report as well as how staff will frame the 2003 payment adequacy/update analyses for hospital inpatient, outpatient, physician, skilled nursing facility, and home health services. Presentations for all of these sectors are planned for the November through January Commission meetings.

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